THE EFFECT OF FRAUD UPON INCORPORATION.[1] — The effect of fraud practised in connection with alleged incorporation is usually raised by an attempt to impeach the corporation collaterally. The invulnerability of *de facto* corporations to collateral attack is generally conceded. May this doctrine, then, be invoked by an organization in answer to a charge that its attempted incorporation was vitiated by fraud?

Evidently no occasion arises for the consideration of this question unless there is failure to incorporate *de jure*. First, then, we must inquire whether the state itself may deny the effectiveness of proceedings attended by fraud. It is essential to distinguish between two types of fraud. (1) A statute requires the filing of a certificate in which shall be a statement that a certain proportion of stock is actually paid up. The incorporators file such a certificate with knowledge of its falsity. (2) A statute authorizes incorporation for purpose A. The incorporators organize in due form, but with the secret intent of using the corporation for the unauthorized purpose B. Suppose the fraud take the first form. If the corporation were chartered by a special legislative act, it might well be that the sovereign's *fiat* would create the corporation despite fraud inducing the creation. And although incorporation is now usually provided for under general enabling statutes, even in such cases if the statute expressly declare that some document, for instance the certificate of the Secretary of State, shall "have the force and effect of a special charter, and shall be conclusive evidence of incorporation," [2] an entire failure to perform conditions prescribed by the statute would seem to be immaterial, and, *a fortiori*, fraud would be unimportant.[3] There is, moreover, a decided tendency to give similar effect to much weaker statutes.[4] It seems a fair construction, however, of a clause calling for certain declarations, that those declarations should at least be *bona fide*. It is believed, therefore, that, unless coerced by the statute, courts should deny *de jure* incorporation in cases where statements required by statute have been made with knowledge of their falsity.[5] But suppose the fraud be of the second type, consisting merely in wrongful motive. If the statute have no express requirement in this regard, it seems reasonable to ascribe to the legislature a negative attitude in the matter, — a desire that the question of motive shall not be thrust upon the courts, which have frequently indicated their disinclination to involve themselves in it. And such seems to be the law.[6] If the fraudulent motive result in fraudulent conduct, the state has an immediate remedy. And if the rights of third parties against such fraudulent organization be not sufficiently protected by appeal to the state official, relief might be furnished in the form of equitable injunction.

We may now consider whether, granting that fraud of the first type suggested has left the organization without *de jure* existence, it may yet invoke the *de facto* doctrine. Whether the reason underlying this doctrine be consideration for the *de facto* organization, or for the court, or some more general ground, it is conceived that it should yield before an attack based, not on

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[1] For a discussion of the question whether the corporate entity should ever be disregarded after admittedly due incorporation, see NOTES, p. 223.

[2] Mass. Rev. L. 1902, c. 110, § 20.

[3] Rice *v.* National Bank, 126 Mass. 300.

[4] See Cochran *v.* Arnold, 58 Pa. St. 399.

[5] See Paterson *v.* Arnold, 45 Pa. St. 410, overruled by Cochran *v.* Arnold, *supra*. See also Davidson *v.* Hobson, 59 Mo. App. 130.

[6] Importing, etc., Co. *v.* Locke, 50 Ala. 332. But see Brundred *v.* Rice, 49 Oh. St. 640.

some technical, mechanical defect, but on allegations of fraud in those who seek protection behind the corporate shield.[7] It must be admitted, however, that there is a somewhat general tendency in the authorities to disregard the distinction between technical oversights, on the one hand, and fraud, on the other.[8] To this effect is a late Missouri Supreme Court decision. *First National Bank* v. *Rockefeller*, 93 S. W. Rep. 761. Such decisions may be accounted for on the supposition that the less frequent cause for collateral attack has been merged by courts in the rule admittedly applicable to the more frequent cause for such attack.

TENTATIVE QUALIFICATIONS OF THE DOCTRINE OF A SEPARATE CORPORATE ENTITY. — Although in our courts the apparently sound conception[1] of a corporation as an organic or psychical reality, separate and distinct from the natural persons composing it, does not obtain, yet, on the basis of a legal fiction, it is in general treated as such an entity. This entity can sue and be sued; be grantor and grantee; and have a continued existence and rights and obligations in contract or tort, wholly independent of those of the individual members.[2] The corporation cannot be confronted with a stockholder's admissions,[3] nor can its property be attached for his debts.[4] Not even a sole stockholder can convey,[5] or sue to recover,[6] corporate property in his own name; nor can the corporation utilize his credits as a set-off.[7] Indeed, in the teeth of public policy, a ship owned by an English corporation composed partly of foreign members has been held entitled to registry "as wholly belonging to Her Majesty's subjects."[8] Yet firmly established and variously applied as is the "fiction" of a corporate entity, a qualifying doctrine has been proposed that under some circumstances it be disregarded.

Of the authorities, many decisions, which only apparently involve heedlessness of the "fiction," must be eliminated from consideration. For example, the adjudications that conveyances to corporations composed of the insolvent grantors are fraudulent, rest not upon the basis that there is no real conveyance, but upon the strong evidence that the conveyances are only to the intent and effect of defrauding creditors.[9] There must likewise be distinguished decisions resulting from *ultra vires* doctrines,[10] and from the doctrine that a fraudulently formed corporation has no legal existence.[11] Moreover, the opinions in the Northern Securities case indicate no belief

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[7] The Christian & Craft Grocery Co. *v.* Fruitdale Lumber Co., 121 Ala. 340.

[8] See Pattison *v.* Albany Bldg. & Loan Ass'n, 63 Ga. 373.

[1] *Cf.* the German view, Holtzendorff's Rechtslexikon, tit. Juristische Person, § 943. See also 19 HARV. L. REV. 222.

[2] See Mor., Priv. Corp., 2 ed., § 232.

[3] Fairfield, etc., Co. *v.* Thorp, 13 Conn. 173.

[4] Williamson *v.* Smoot, 7 Martin (La.) 31.

[5] Parker *v.* Bethel Hotel Co., 96 Tenn. 252.

[6] Button *v.* Hoffman, 61 Wis. 20.

[7] Gallagher *v.* Germania, etc., Co., 53 Minn. 214.

[8] The Queen *v.* Arnaud, 16 L. J. Q. B. (N. S.) 50. See also Foster *v.* Commissioners of Inland Revenue, [1894] 1 Q. B. 516.

[9] See Booth *v.* Bunce, 33 N. Y. 139. But *cf.* First, etc., Bank *v.* Trebein Co., 59 Oh. St. 316.

[10] See Mill *v.* Hawker, L. R. 9 Exch. 309.

[11] See Brundred *v.* Rice, 49 Oh. St. 640; also NOTES, p. 222.